

CHANGING THE WAY WE CLASSIFY INDUSTRIES

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The North American Industry Classification System (NAICS) is the new standard for the industrial classification of businesses. The North American Industry Classification System is replacing the Standard Industrial Classification (SIC) system used for 60 years to categorize establishments in the United States. It is not a mere revision of SIC, but a new and more comprehensive classification system. Several government agencies, including the U.S. Bureau of Labor Statistics (BLS), began the laborious process of assigning new codes to approximately 8.2 million employers covered by unemployment insurance laws in 1997. After six years of hard work, the conversion from SIC to NAICS is complete.

Passage of the North American Free Trade Agreement (NAFTA) in January 1994 led to a need for meaningful statistics about products, sales, and employment across the borders of the United States, Canada, and Mexico. To meet this need, the three countries would have to use the same classification system to allow for direct comparisons of economic data. The North American Industry Classification System was developed in cooperation with foreign partners Statistics Canada and Mexico's National Institute of Statistics, Geography and Informatics (INEGI). More information about NAICS can be found on the Internet by visiting the BLS site at <http://www.bls.gov/bls/naics.htm>. Statistics Canada's web address is <http://www.statcan.ca/start.html> and INEGI's web address is <http://www.inegi.gob.mx/difusion/ingles/portadai.html>.

The need for a new system also reflected widespread concern that the SIC system no longer reflected the structure of the U.S. economy. To deal with these issues, three major federal statistical agencies, BLS, U.S. Census Bureau, and Bureau of Economic Analysis (BEA), decided to develop a new industrial classification system with input from both data users and data producers. The NAICS focuses on the identification of new and emerging industries and provides increased detail in the services compared to what was available under the SIC system.

The numeric system of NAICS coding has no relationship to that of SIC. There are 20 broad categories in NAICS compared to only 10 divisions in SIC. The highest level of NAICS classification is called the sector, corresponding roughly with the division level in SIC. The NAICS has five levels of classification within detailed codes that have a maximum of six digits. SIC provided only four levels of classification within four-digit detailed codes. Many of these new sectors reflect recognizable parts of SIC divisions, while other sectors represent combinations of pieces from more than one SIC division. For instance, the *Utilities* and *Transportation* sectors were separated from the *Transportation, Communications, and Utilities* division, and the *Services* division under SIC has been subdivided to form several new sectors under NAICS. The new *Information* sector includes major components from the SIC divisions of *Transportation*,

Communications, and Utilities (broadcasting and telecommunications), *Manufacturing* (publishing), and *Services* (software publishing, data processing, information services, motion picture and sound recording). The *Accommodation and Food Services* sector combines hotels and other lodging places from *Services* with eating and drinking places from *Retail Trade*.

NAICS will better reflect today's industrial mix by separately recognizing for the first time over 350 industries such as bed and breakfast inns, cable networks, casinos, environmental consulting, health maintenance organizations, medical centers, nail salons, pet supply stores and pet care centers, satellite communications, semiconductor machinery manufacturing, telemarketing centers, temporary help suppliers, warehouse clubs, and weight reduction centers. Under the SIC system, many unrelated services and products had to be grouped under the *Not Elsewhere Classified* category in each industrial sector. For example, SIC 7389 (*Business Services, Not Elsewhere Classified*) included such disparate services as wig styling, telemarketing, swimming pool cleaning, check validation, special events decorating, and embroidering advertising on shirts.

The NAICS uses a production-based concept of classification. Under the SIC system, some establishments were classified by the production processes they used, but others were classified by different criteria, such as whether their customers were retail or wholesale. The NAICS consistently focuses on grouping establishments with similar activities and processes, rather than focusing on what is produced or on who buys the products. As a result of this focus, the NAICS reclassification will substantially change which businesses are included in certain sectors. For instance, establishments considered to be engaged in wholesale trade under the SIC system, such as the sale of used auto parts or office furniture, could be reclassified as retail trade if they are open to the public. Under NAICS, establishments that sell merchandise in small quantities using public-oriented methods like mass media advertising and high-traffic locations are classified as retailers. Establishments that sell merchandise in large quantities using business-oriented sales methods, such as specialized catalogs and warehouse locations closed to the public, are classified as wholesalers.

Under NAICS, auxiliary establishments will also be classified differently than under SIC. Auxiliary establishments—those that provide services such as warehousing or data processing to other organizations within the same company—were classified in the same industry as their parent companies under SIC. The NAICS classifies each auxiliary establishment according to the services they provide.

This part of the article focuses on some of the shifts Idaho's economic development and academic researchers face when analyzing non-seasonally adjusted BLS backcast data for Idaho's new NAICS industries. It also focuses on a few of the challenges when comparing some of Idaho's NAICS data to Idaho's SIC data for major sectors.

Idaho's economic development and academic researchers use industrial and business statistics to measure the local economy and to conduct market analysis and impact

studies. One of the challenges they face is comparing BLS data over time. Unless Idaho's researchers and economists understand the new NAICS classification system and its inherent employment shifts, they cannot perform the research and analysis requested by their employers and clients. While most historical SIC data is available, comparing historical SIC data to current NAICS data will be very difficult due to new NAICS industries, the shifting of existing industries, and the shifting of industries in *Goods-Producing* to *Services-Providing*.

NAICS has added many industries and sectors that were unknown in the SIC system. These were created by the reclassification of corporate offices and SIC industries such as *Business Services*. For example, corporate offices were assigned the SIC code that reflects their company, not their function. Under NAICS, Business Services is mostly spread out among three new industries, the two mentioned previously and the new *Professional, Scientific, and Technical Services* industry. Other NAICS industries that deserve mentioning for Idaho are *Information and Computer and Electronic Product Manufacturing*. *Information*, which includes *Publishing*, (formerly under the SIC *Manufacturing* division) is now part of the NAICS *Service-Providing Industries*. *Computer and Electronic Product Manufacturing* represent Idaho's hi-tech industry.

A starting place for Idaho's economic development and academic researchers to understand the transition from SIC to NAICS is to understand the employment shifts between *Goods-Producing Industries* and *Service-Providing Industries*. The difference between SIC and NAICS for *Goods-Producing Industry* is offset by the difference between SIC and NAICS for *Service-Providing Industries*. These offsets are not unique to Idaho. In all states, as well as the nation, the differences between SIC and NAICS for *Goods-Producing Industries* offset the differences between SIC and NAICS for *Service-Providing Industries*, however, the magnitudes of the differences vary. On average, the conversion from SIC to NAICS decreased Idaho's employment in *Goods-Producing Industries* by more than 5 percent.

As already determined, after converting from SIC to NAICS, the decreases in *Goods-Producing Industries* must be offset by an increase in *Service-Providing Industries*. On average, the conversion from SIC to NAICS increased Idaho's employment in *Service-Providing Industries* by more than 1 percent.

Even though, the number of jobs shifting from *Goods-Producing Industries* to *Service-Providing Industries* has a net difference of zero after converting from SIC to NAICS, the percentage changes in each sector are different. This is because nonfarm employment is not equally divided between the *Goods-Producing Industries* and the *Service-Providing Industries*. The *Service Providing Industries* has a much larger employment base than its *Good-Producing Industries* counterpart.

In the *Manufacturing* industries, the conversion from SIC to NAICS and the corresponding backcast resulted in a decrease of 7,000 to 10,000 people in any given year. The reclassification of some SIC businesses previously in *Goods-Producing*

Industries, such as *Publishing* mentioned earlier, is partly responsible for the shifting of these jobs to NAICS *Service-Providing Industries*.

Even though the data shows a net change in employment of zero from *Goods-Producing Industries* to *Serve-Providing Industries*, the reclassification of businesses and industries within the *Service-Providing Industries* can create difficulties when performing historical analysis on some affected industries. The conversion from SIC to NAICS caused a decrease in Idaho's *Retail Trade* sector of 21,000 to 35,000 any given year of the backcast from 1990 to 2000. This employment shifted out of *Retail Trade* and into other NAICS *Service-Providing Industries* such as *Management of Companies and Enterprises*.

Fortunately there are a couple of NAICS industries that are of particular interest to Idahoans that almost match up one-for-one with their corresponding SIC counterparts. These are *logging*, which is no longer part of *Manufacturing*; but is now part of the *Natural Resources* sector. The changes in employment for these two industries were negligible during the conversion from SIC to NAICS.

Now that the BLS has fully converted Current Employment Statistics data from SIC to NAICS, Idaho's researchers and economic development professionals can finally analyze the inherent employment shifts associated with the conversion process. Even though Idaho's net change between SIC and NAICS is zero, analyzing the internal employment shifts are very difficult due to the many NAICS reclassified businesses and industries. This is compounded when forced to compare twenty sectors under NAICS to only ten divisions under SIC. However, there is some solace in the fact that the BLS has provided historical NAICS backcast data to aid in understanding these employment shifts.